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DIRECTORATE OF
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Intelligence Memorandum

Implications of Iraqi Plans to Exploit the North Rumaila Oil Deposits

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1968

INTELLIGENCE MEMORANDUM

Implications of Iraqi Plans to Exploit the North Rumaila Oil Deposits

Summary

In April 1968 the Iraqi government announced plans to develop the North Rumaila oilfield through the state-owned Iraq National Oil Company (INOC). Production is to be about 100,000 barrels per day (bpd) at the end of the first stage of development, which is to take about three years, and 360,000 bpd at the end of the second stage, whose completion date is uncertain. North Rumaila, located in southern Iraq (see the map), is a rich oil formation. The deposit has been fully explored; proved reserves are estimated to be at least 10 billion barrels, and the field eventually could produce at a rate of 400,000 to 600,000 bpd.

The Iraqi plan appears to be realistic. Iraq probably can arrange financing from its own resources, can secure the technical assistance it needs from either Free World or Communist countries, and probably can make marketing arrangements for the relatively small amounts of oil involved. The USSR appears to have offered Iraq technical and possibly also marketing assistance in a tentative agreement announced in December 1967.

Control of the North Rumaila field has been the principal bone of contention in a dispute between the government of Iraq and the Iraq Petroleum

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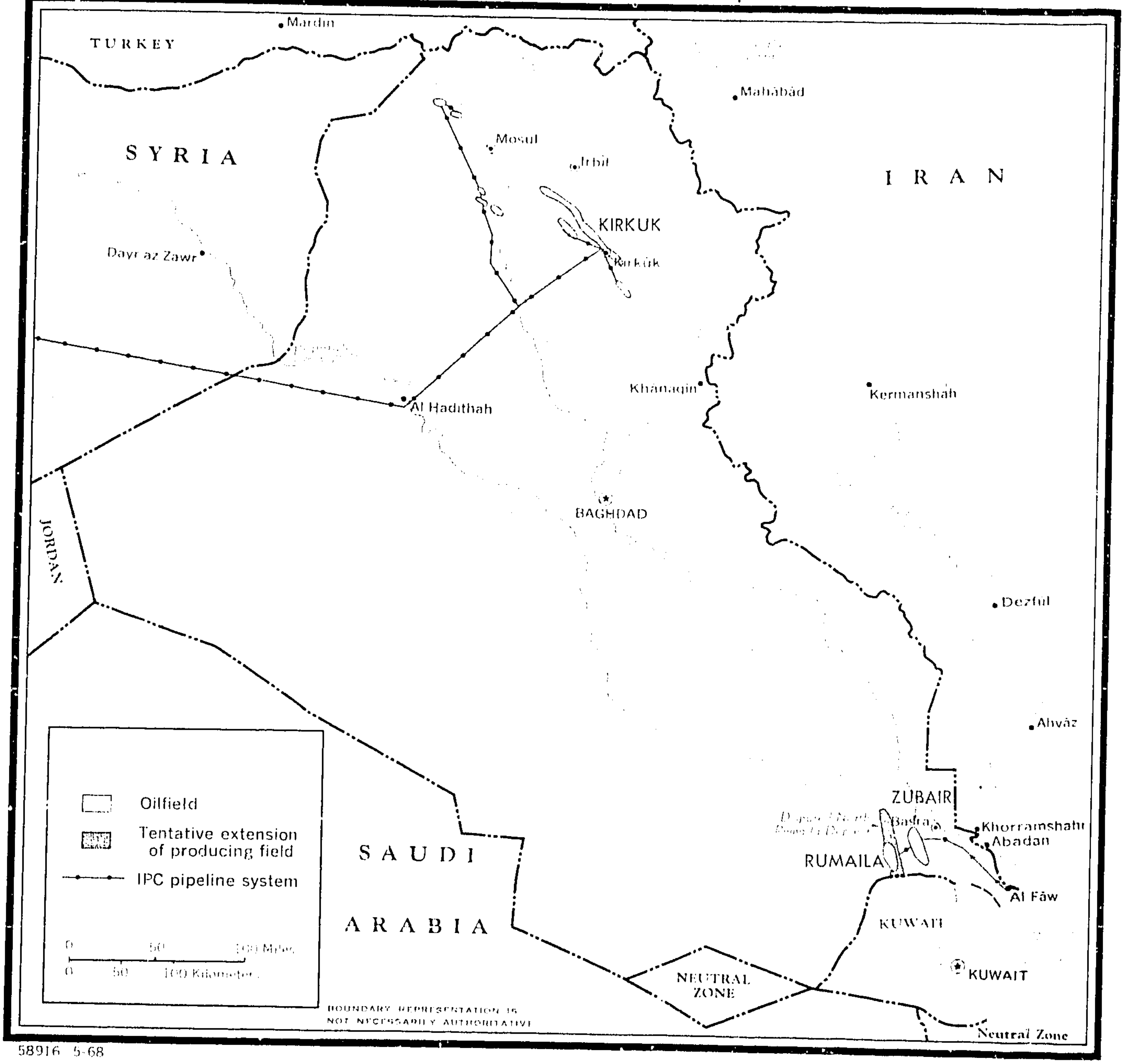
Company (IPC), the foreign-owned consortium that has enjoyed a virtual monopoly on Iraqi oil development in the past. In 1961, Iraq passed a law which restricted the IPC oil operations to areas then in production and thereby denied the unexploited North Rumaila deposit to IPC. Political sentiment in Iraq blocked agreement over North Rumaila in spite of the large potential economic benefits to Iraq since IPC has made virtually no new investments over the past five years. As a consequence, petroleum output in Iraq has been expanding at a lower rate during the 1960's than in any other major Middle East producer. Iraq's decision to exploit North Rumaila on its own also was inspired by political motives, since it entailed the rejection of economically more profitable options. Iraq rejected offers from the IPC, from an Italian company, and from two French oil companies. These latter offers were made at the urging of the French government, which undoubtedly is disappointed by Iraq's action. By rejecting one French offer, Iraq will have forgone about US $500 million in net revenue in the early years of the project.

Iraq expects its plan to bring in government revenues of US $45 million annually after the first stage of development and $165 million annually after the second stage of development is completed. Since the IPC is unlikely to invest in Iraq and existing facilities are being fully utilized, the North Rumaila field offers the only prospect for increasing oil production substantially. Even if this field is developed on schedule, Iraqi oil revenues will not increase as rapidly as they have in the past several years.

The Iraqi action, by setting an example for other oil-producing countries, may lead to an increase in the demands of these countries on the major oil companies in future negotiations. IPC probably will take legal action but is unlikely to be successful.

IRAQ: IPC (Iraq Petroleum Co.) Oilfields And The North Rumaila Deposit



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Background

1. The North Rumaila oil deposit in southern Iraq has been the principal element in a dispute between the Iraq Petroleum Company (IPC) and the government of Iraq since 1961. In that year the government of Iraq passed Law 80 by which 99.6 percent of the original IPC concession, which covered almost all of Iraq and which was not then being actively exploited by IPC, reverted to the government. In effect, the law restricted IPC operations to the 2,000 square kilometers or so of the original concession from which it was then producing. This action was a political gesture against "foreign imperialists" and apparently stemmed from disappointment at the rate IPC was exploiting the oil resources. More attractive financial arrangements with other oil companies were hoped for.

2. The North Rumaila deposit was included in those areas reclaimed by the government. The IPC had explored and proved the area but had not started production at the time Law 80 was passed. North Rumaila is one of the richest single identified oil formations in the country and is the most likely source of any substantial increase in Iraq's oil production in the foreseeable future. Proved reserves in North Rumaila probably exceed 10 billion barrels, representing between 25 and 50 percent of Iraq's total proved reserves, and the deposit could be developed to produce between 400,000 and 600,000 barrels per day (bpd) in two or three years.

3. In 1965 an agreement was reached between the IPC and the government of Iraq by which North Rumaila would be restored to the IPC and other outstanding less important issues would be settled. Internal political pressures delayed ratification of the agreement, and the Arab-Israeli war in mid-1967 apparently doomed any such settlement.

4. In August 1967, Iraq passed Law 97 giving the government-owned Iraq National Oil Co. (INOC) exclusive rights to exploit all of Iraq's oil and gas resources except those retained by the IPC under Law 80. In addition, Law 97 stipulates

that the resources assigned to the INOC should be "developed directly by it;" but association with others, if "more conducive to the fulfillment of its objectives," was authorized.

5. Recently, representatives of oil interests in Italy, Japan, Spain, and France discussed with Iraq the possible exploitation of North Rumaila. Two French companies [redacted] showed particular interest. 25X1
Enterprise de Récherches et D'Activités Pétrolières (ERAP), a French state-owned enterprise that has contracts with the government for oil activities elsewhere in Iraq, discussed possible operations in North Rumaila but subsequently discontinued negotiations. The other French company, Compagnie Francais des Pétroles (CFP), one of the owners of the IPC, offered to develop North Rumaila, to construct necessary auxiliary facilities, and to purchase an average of 400,000 bpd of oil for 20 years. Annual revenues would be about $160 million for Iraq. On 10 April 1968, however, Iraq announced that the offers by foreign firms were less than what Iraq could achieve by its own direct exploitation and disclosed plans for the INOC to exploit the Rumaila deposits.

<u>Iraqi Plans to Exploit North Rumaila</u>

6. Iraq plans to develop North Rumaila in two stages. Production by the end of the first stage, scheduled to take three years from the start of development, is to be about 100,000 bpd, and annual revenues are expected to be about $45 million.* During the second stage, for which no details as to time schedule have been given, production is to be developed further to a rate of about 360,000 bpd. At this rate of production, annual revenues would be approximately $160 million.

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* *Iraq bases this estimate on a unit price of $1.20 per barrel calculated from the current posted price of $1.76 less the prevailing discount of 40 cents per barrel and less estimated production costs of 16 cents per barrel.*

7. Iraq plans to spend about $17 million on the first stage of development. About one half will be for the construction of a 16-inch pipeline from the oilfield to tidewater at Fao (Al Faw), about 80 miles. About $3 million is to be spent on each of the following: oilfield gathering and treating systems, storage facilities, and the expansion of existing facilities at the oil port of Fao. Expenditures for drilling probably would cost an additional $6 million to $7 million, bringing the total cost of the first stage to about $24 million.

8. During the second stage, an estimated $40 million to $50 million would be required for development. Additional wells would have to be drilled, a new pipeline probably would be required, and deep-water marine loading facilities would have to be constructed.

9. The Iraqi plan is feasible. The North Rumaila deposit will support the production goals established for the first and second stages and the proposed oil sale price appears to be competitive. Implementation of the plan on schedule, however, is contingent on Iraq's ability to obtain outside assistance.

Possible Sources of Assistance for Iraq

10. Law 97 precludes exploitation of North Rumaila as a joint venture, whereby the partner acquires part ownership of the oil, or the granting of concessions. Thus, INOC appears to have only two courses of action open to it: to arrange a service contract or to obtain direct technical assistance in the form of personnel and equipment.

11. Under a service contract, such as was offered by one of the French oil companies, CFP, the contractor would advance funds to cover developmental costs repayable in oil, if found, and would assure a market for most of the oil. Iraq is not likely to make such an arrangement in light of its rejection of the CFP offer. Iraq probably reasons that, because minimal risk is involved in

developing the proved deposits in North Rumaila, it can obtain the modest capital requirement from its own resources and that its needs for technical assistance can be met in other ways.

12. Technical assistance probably could be acquired in the Free World or in the USSR and Rumania. Although details of the Soviet/Iraqi discussions on oil matters in Baghdad in December 1967 were not published, the USSR did agree to provide equipment and services for the development of Iraq's oil industry, to drill wells in southern Iraq, and to assist in the transport and marketing of INOC oil. The development plan for North Rumaila probably will be discussed in new meetings planned for Moscow in the spring of 1968.

Marketing of North Rumaila Oil

13. Despite the growing competition of additional, but small, quantities of oil from new and independent sources of supply throughout the Middle East and Africa, Iraq almost certainly will be able to sell the quantity of oil to be produced by the end of the first stage of development. Iraq probably would not undertake the second stage of development unless it had reasonable assurance of a market and could, if necessary, defer the second stage until markets for the increased production were assured. Although the profits envisaged by Iraq imply the sale of North Rumaila oil for hard currencies, the Iraqis may barter some of this oil in Eastern Europe and Asia.

Effects on the Economy of Iraq

14. The development of the North Rumaila field will have a negligible effect on the economy or on government revenues of Iraq in the short run. Production at the initial rate of 100,000 bpd will not begin until after completion of the first stage, estimated to take three years. Moreover, most of the anticipated revenues from the sale of the oil ($45 million per year) will be obligated to the development planned for the second stage. However, when the second stage is completed and production reaches 360,000 bpd, Iraq expects sales of this oil to earn almost $160 million per year.

15. In 1968, oil exports, which provide about 60 percent of total revenues, are expected to earn about $500 million for Iraq, and no substantial increase from the fields currently being exploited is expected in the foreseeable future. The IPC has made only minimum essential capital improvements since the dispute began in 1961, and the Iraqi decision certainly will not improve the investment climate for IPC. Without substantial capital expenditures, production by IPC is limited by the condition of producing formations, internal transport facilities, and export loading facilities which are being used at full capacity and will remain at or near the current level of about 1.5 million bpd.

16. The oil revenues anticipated from North Rumaila after completion of the second stage may increase Iraq's total oil revenue some 30 percent over the 1968 level to about $660 million. If completion of the second stage takes seven years -- perhaps an optimistic assumption -- Iraq will have achieved a considerably smaller growth in revenues than over the past seven years,* which was a period of only spotty economic progress.

17. By developing North Rumaila on its own, the government has forgone some substantial economic gains. Although the plan ultimately may bring about the same annual revenues as the CFP offer, the full amount from the latter would have been received at least three years earlier. CFP had promised to pay Iraq $165 million a year beginning three years after development began. This means that Iraq will have forgone probably nearly $500 million in net revenue in the three years following completion of the first stage. In addition, revenues from the CFP offer would have been in hard currencies, which may not be the case if sales are made to Communist countries and others on a barter basis.

* *Oil revenue probably will have increased 90 percent during 1961-68.*

Implications of the Iraqi Actions for Western Oil Interests

18. The outcome of the Iraqi plans for North Rumaila may have significant long-run effects on the IPC and other Western oil interests. The chances are that the plan will succeed at least in the first stage -- no over-riding obstacles are presently foreseen -- and that the IPC will be willing to continue operating in Iraq. Other oil-producing countries may therefore see a quick way to advance the fortunes of their own national oil companies without jeopardy to their principal source of income. The quantity of oil involved in the Iraqi plan is not large enough to have a significant effect on world oil markets or on oil prices.

19. In future hard-headed negotiations between host governments and the operating companies, the former may demand the relinquishment of a proved oil deposit or even a producing field in return for a settlement. Such a "windfall" would save a national oil company the high costs of exploration and development and speed the time when the company could sell its own oil in world markets.

20. The IPC can do little about the proposed action. The IPC rejects as illegal all actions related to Iraqi Law 80 [redacted] 25X1

It must do this to protect its claim to North Rumaila and to discourage other governments from following Iraq's example.

21. The IPC is unlikely to succeed in these law suits, however. There is a historical but unsuccessful precedent in the actions envisaged by the IPC. In the 1950's a dispute arose between the government of Indonesia and Shell Oil Company over ownership of oil produced in North Sumatra. Shell initiated legal action, without success, against purchasers of that oil and subsequently abandoned its effort. In addition, enforcement of a successful legal action would be difficult. Iraq could, for example, obtain

royalty oil and mix it with North Rumaila oil prior to sale and a plaintiff would be at a loss to identify or designate the disputed oil.

22. Finally, the IPC is vulnerable to harassment from the Iraqi government against its operations elsewhere in Iraq if it initiates legal action. The IPC probably will make serious efforts, including compromise if necessary, to continue its highly profitable operations. The unit cost of oil production in Iraq is as low as anywhere in the Middle East.

23. The IPC, and probably many other Western oil companies, almost certainly would exert pressure where possible to prevent any Free World company from providing services and equipment to Iraq to develop North Rumaila. There are companies, however, in West Germany and Japan, for example, that may be sufficiently invulnerable to such pressures to assist Iraq. Similarly, there are markets not dominated by the owners of the IPC where the oil could be sold.